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Japan's Current Account Surplus Soared In 1991

Japan's 1991 current account statistics demonstrate that a rising surplus in total trade in goods and services is nothing to cheer about. Part of the reason is political. The apparently slow pace of the contraction in the Japanese surplus in the late 1980s was a sore point in Washington-Tokyo relations; the doubling of the imbalance to $72.6 billion in 1991, reversing three years of declines, is even worse from this standpoint (see Table 1). In the fourth quarter alone Japan's current account surplus jumped to $24.1 billion, the highest quarterly level since 1986 and nearly triple the comparable 1990 figure of $8.1 billion. As such, the latest figures are likely to exacerbate already tense relations between the two economic superpowers. A geographic breakdown is not yet available, but if, as is likely, the pattern follows that of the customs-clearance trade figures released earlier (see *JEI Report* No. 5B, February 7, 1992), Washington's displeasure may be nothing next to that of Europe and Asia, which registered larger increases in their bilateral trade deficits with Japan than did the United States.

Tokyo has reason to worry about the latest figures for economic reasons as well. The pattern of capital flows during 1991 suggests that Japanese financial institutions lacked confidence in the health of both their economy and that of Japan's trading partners. The data indicate that Japanese participants in international markets retreated to the sidelines last year, letting others take the initiative (see Table 2). For example, direct investment abroad dropped more than a third from 1990's level. This confirms indirect evidence that, while Japanese companies continued in 1991 to add to their stock of foreign factories, real estate and other overseas assets over which they have direct control, they did so far more slowly than in the late 1980s, although the figures do not suggest that the cumulative stock of real foreign assets was being reduced.

Somewhat the same situation existed with portfolio investment, where individual Japanese investors are assumed to play a more passive role than with direct investment if only because their world share relative to other investors is much smaller. In 1991 Japanese overseas investors increased their holdings of stocks and bonds by a larger amount than in 1990, but they easily were outspent by

Table 1: **Japan's Balance of Payments**

(in millions of dollars, IMF value basis)

	1987	1988	1989	1990	1991*
Current Account	$87,015	$79,631	$57,157	$35,761	$72,598
Trade Balance	96,386	95,012	76,917	63,528	103,289
Exports (f.o.b.)	224,605	259,765	269,570	280,374	306,597
Imports (f.o.b.)	128,219	164,753	192,653	216,846	203,308
Services	-5,702	-11,263	-15,526	-22,292	-18,220
Transfers	-3,669	-4,118	-4,234	-5,475	-12,471
Long-Term Capital	-136,532	-130,930	-89,246	-43,586	36,628
Basic Balance	-49,517	-51,299	-32,089	-7,825	109,226
Short-Term Capital	23,865	19,521	20,811	21,468	-26,352
Errors and Omissions	-3,893	2,796	-22,008	-20,877	-6,505
Overall Balance	-29,545	-28,982	-33,286	-7,234	76,369

*Preliminary.

Source: Bank of Japan

Table 2: **Net Long-Term Capital Flows**

(in millions of dollars)

	1990			1991*		
	Outflows	Inflows	Net	Outflows	Inflows	Net
Direct Investment	$-48,024	$1,753	$-46,271	$-31,167	$1,368	$-29,799
Trade Credits	681	-10	671	4,380	-3	4,377
Loans	-22,182	39,112	16,930	-13,538	38,126	24,588
Securities	-39,681	34,653	-5,028	-74,306	115,284	40,978
Stocks	-6,256	-13,276	-19,532	-3,630	46,833	43,203
Bonds	-28,961	16,991	-11,970	-68,202	21,236	-46,966
Yen-Denominated Bonds Issued in Japan	-4,464	n.a.	-4,464	-2,474	n.a.	-2,474
External Bonds**	n.a.	30,938	30,938	n.a.	47,215	47,215
Other	-11,560	1,672	-9,888	-7,245	3,729	-3,516
Total	-120,766	77,180	-43,586	-121,876	158,504	36,628

Note: A negative sign indicates a capital outflow.

*Preliminary.
**Bonds issued outside of Japan by Japanese institutions.

Source: Bank of Japan

foreigners snapping up substantial numbers of Japanese bonds as well as $46.8 billion of what they hoped would turn out to be bargains in the depressed Japanese stock markets. As a result, Japan's net portfolio position declined.

The net effect of the trends in Japanese direct investment, portfolio investment and other capital flows last year was a net long-term capital inflow of $36.6 billion, the first since 1980. While a short-term outflow of $26.4 billion largely offset this amount, Japan still was left with a positive net inflow combined with a larger current account surplus, a development apparently inconsistent with double-entry bookkeeping principles and one certain to give good accountants bad headaches. Normally, net capital outflows are the means by which Japan's trading partners finance their trade deficits with that country; as Table 1 shows, long-term capital outflows in the late 1980s tended to move in tandem with the current account surplus. Logically, then, the outflow should increase — not decrease, let alone reverse to become an inflow — when the surplus expands. Yet exactly this apparently incongruous result occurred in 1991.

This aberration is reflected in the bottom line of Table 1 in the record-high figure for the overall balance. Any number — positive or negative — for the overall balance would seem impossible given the rules of accounting. On examination, however, the overall balance turns out to be something other than the bottom line. The apparent discrepancy between movements in the current account and the capital account is explained by changes in Japan's foreign exchange reserves and in the net liabilities of authorized foreign exchange banks. These two remaining sources fill the gap between the current account and the long- and short-term capital flows described in Table 1.

Foreign exchange movements, however, were not the explanation in this case. Last year Japan's foreign exchange reserves fell by $8.1 billion, suggesting that foreign governments were not borrowing from Tokyo to counterbalance their countries' trade shortfalls. The explanation thus reverts to authorized foreign exchange banks. In 1991 these banks, which had become large net borrowers on international markets in recent years, reduced their international liabilities by a whopping $91.7 billion, resulting in a 36 percent reduction in the banks' outstanding debt in just 12 months. This single item alone was enough to finance the larger current account surplus, the increased capital inflows into Japan and the drop in foreign exchange reserves.

Of course, reducing liabilities is formally equivalent to increasing assets as a means of financing the worldwide capital shortage that some Japanese have argued is an appropriate international role for Japan. However, the fact that authorized foreign exchange banks, including the 11 Japanese nationwide commercial banks, began paying off their overseas borrowing could suggest that they saw few profitable opportunities abroad. In any case, the phenomenon implies a less aggressive stance for Japanese banks overseas. This approach hardly seems an indication of economic strength, but it is consistent with institutional pessimism in Japan concerning the country's own stock market and relatively sluggish overseas direct investment. Regardless of the perspective — from abroad or from Japan itself — the 1991 current account figures and the investment behavior that generated them surely are no reasons to activate a cheering section.

Douglas Ostrom

Japan Tries To Break Bears' Grip On Stock Market

The Tokyo Stock Exchange remains tightly gripped by bearish investors concerned over Japan's mixed economic news. The TSE's inability to shake off pessimism contrasts sharply with the New York Stock Exchange's ebullient mood, which has pushed market indexes to record levels. Japanese industry and government officials are both vexed and worried by the TSE's slump. The market's doldrums prevent companies from raising equity capital, thus restraining investment by nonfinancial firms and lending by banks. They also cut the value of Japanese banks' stock portfolios, which makes banks even less able to extend new loans. Moreover, the slump damages consumer

confidence, contributing to the erosion of the largest component of domestic economic activity — consumer spending. At the same time, the stock market's lukewarm reaction to traditional support measures reveals the impact of financial deregulation and the limits on the ability of the government and other agents to influence the market.

After dropping nearly to the 20,000 mark — a critical level for bank stock portfolios — in the first half of January, the Nikkei average of 225 selected issues struggled back to the 21,000 range in the latter part of the month, due mainly to efforts by the Bank of Japan to lower short-term interest rates (see *JEI Report* No. 2B, January 17, 1992). Volume, however, remained very light, rarely topping 150 million shares traded daily.

In such a thin market the impact of arbitrage trading between the spot market, where actual shares are traded, and the derivative market, where stock futures and options contracts are bartered, can be decisive. To address these concerns the governing board of the Osaka Securities Exchange, Japan's second-largest market, announced January 23 that it was initiating a review of the rules governing stock index futures traded on the OSE. Based on the Nikkei 225 average, the OSE futures contract is the primary futures instrument in Japan. Initiated in mid-1989, the OSE futures market has been accused of disrupting the underlying TSE spot market every three months when futures contracts are settled. OSE President Hiroshi Yamanouchi said the board was reviewing the disclosure of futures trading information, the method of fixing settlement prices, the impact of current futures trading hours and the trading of futures by brokers for their own accounts. Brokers welcomed the OSE's rule review, generating some positive sentiment and helping to push the Nikkei above 22,000 January 31. But the momentum was short-lived. The TSE drifted lower until February 6 when it again rose above 22,000; that rise came in response to the OSE's announcement the previous day that its review had led to some changes expected to reduce the influence of futures trading on the spot market.

The ruling Liberal Democratic Party also is engaged in talking up the market. LDP secretary general Tamisuke Watanabe's suggestion January 31 that the LDP should investigate measures to prop up the market helped to ignite a 465-point rally that day. The efficacy of this type of jawboning clearly has limits, however. LDP Vice President Shin Kanemaru on February 13 called for a 0.5 percentage point cut in the 4.5 percent discount rate to boost the economy. Rather than responding positively, investors stayed on the sidelines that day; in fact, sell orders overwhelmed purchases, and the Nikkei lost 150 points.

The LDP's February 14 release of more concrete suggestions to support the market also failed to generate an immediate positive response. The ruling party's proposed steps included a reduction in the securities transaction tax (currently either 0.12 percent or 0.3 percent of the sales price, depending on the type of securities bought or sold), rule changes to allow pension and trust fund managers to put a greater portion of their portfolios into stocks, incentives for companies to raise dividend rates and revocation of the ban on firms trading their own stocks. While the LDP study group releasing the package said a discount rate cut would help, it avoided a direct call for such a move. Analysts said the measures might help the market in the medium term but would have little immediate effect. Investors apparently agreed; the TSE dropped more than 507 points February 14 to close below 21,000 (see Graph).

Japan's top four brokerage firms — Nomura Securities Co., Ltd., Daiwa Securities Co., Ltd., Nikko Securities Co., Ltd. and Yamaichi Securities Co., Ltd. — already had met earlier this year to discuss market support measures; reports of these talks had little impact on investor confidence. Trying again, the Big Four issued a call February 13 for the Ministry of Finance to ease two of its guidelines. The first, imposed in 1989 to limit the oligopolistic influence of the Big Four, prevents any broker from handling more than 30 percent of any single stock's monthly trading volume. The second, imposed in 1990 to calm market volatility, prevents securities firms from trading for their own accounts during the last 15 minutes of both the morning and the afternoon trading sessions. Judging from the TSE's downward drift of February 13 and 14, the market was unimpressed with these ideas.